Fairlight Capital

August 10, 2025

Fairlight Alpha Fund LP

Q2 2025 Letter

Dear Partners,

Fairlight Alpha Fund's second quarter 2025 returns were 9.3% net of fees. This compares to 10.9% for the S&P 500 Total Return index. Overall, since inception the fund has returned 684.6% net of fees and 38.4% on an annualized basis. These results are presented for informational purposes only and do not represent a solicitation or offer.

Performance vs. the S&P 500

We track the net asset value of Fairlight Alpha Fund (the "Fund") over time as calculated by our fund administrator based on our portfolio positions and prices over time on a dollar basis. The fund financials are also audited each year by an independent auditor with the assistance of the Fairlight management company and the fund administrator.

The tables below show the S&P 500 total return and partnership net returns, after fees, for each year 2019-2025 (YTD), followed by the compounded returns over the same period, as well as the annualized gains.

Annual Returns

Year		Fairlight Alpha Fund	S&P 500 (Total Return)	Difference
2019[1]	………………………........	38.1%	17.9%	20.1%
2020	…………………………	26.3%	18.4%	7.9%
2021	…………………………	146.5%	28.7%	117.8%
2022	…………………………	15.8%	-18.1%	33.9%
2023	…………………………	6.9%	26.3%	-19.4%
2024	…………………………	13.6%	25.8%	-12.2%
2025 (YTD)	…………………………	29.8%	5.5%	24.2%

Compounded Returns

Year		Fairlight Alpha Fund	S&P 500 (Total Return)	Difference
2019[1]	………………………........	38.1%	17.9%	20.1%
2020	…………………………	74.4%	39.6%	34.7%
2021	…………………………	329.9%	79.7%	250.2%
2022	…………………………	397.9%	47.2%	350.7%
2023	…………………………	432.2%	85.9%	346.4%
2024	…………………………	504.6%	133.8%	370.8%
2025 (YTD)	…………………………	684.6%	146.8%	537.8%
Annualized Gain	…………………………	38.4%	15.3%	23.1%

[1] The Fairlight Alpha Fund was launched on 01-Mar-2019 and so the 2019 performance and returns are presented for a 10-month period.

(1) The S&P 500 returns represent the total return index, i.e., with dividend reinvestment included. Increases in value arise from stock price appreciation as well as dividend reinvestment. This provides a fairer comparison to the fund.
(2) The Fairlight Alpha Fund performance is shown net of partnership fees and expenses.

The fund has outperformed the S&P 500 total return for the first half of 2025. In spite of the volatility over the quarter we maintained the outperformance of the fund and took advantage of price changes to rotate in order to optimize the portfolio. We will discuss the markets and the portfolio specifically in the following sections, along with updates on several of these businesses and what we believe to be their future outlook.

Market and Portfolio Performance

Fears relating to the U.S. tariff changes and what has so far turned out to be a V-shaped recovery dominated the first half of the quarter. Our portfolio followed the general pattern of the market, but our performance came from specific ideas, such as certain technology names and the junior gold miners. The perceived increased risk and uncertainty also appeared to push the price of gold from the $3,000/oz area to above $3,300/oz during the quarter.

Alongside this came the potential for returns from AI and AI-adjacent names, like the infrastructure businesses. We saw many investors take note, and took increasing notice ourselves, of the increasing flow of investment into the construction of AI data centers. Businesses that supply computing power and energy to these data centers had already risen a lot, but some names remained cheap, such as those supplying pipes, cooling systems, and concrete structures for these buildings. Several of these names have benefitted from increases in general infrastructure investment.

Overall in the quarter the S&P 500 index gained by 10.6% (excluding dividends). The index has now reached an earnings valuation multiple of 27.6[2]. This is high relative to historical averages. From the Second World War to the 1990s the PE typically varied in the range of 10-20x, increasing subsequently, and then spiking in the Global Financial Crisis as the E in the ratio fell precipitously. The ratio has generally been increasing since then, excluding the Covid period when it spiked and fell back.

In addition, companies in high-growth sectors often report artificially low earnings because R&D and sales and marketing, which are really investments in future growth, are expensed immediately. As a result, the S&P 500 today contains more firms today where reported profits are structurally suppressed relative to underlying cash generation, helping to explain why headline P/E ratios appear higher than historical norms.

On the other hand, one could argue that higher PEs still reflect genuine risk: not all R&D and sales spending delivers returns, and some companies may be investing aggressively without clear paths to profitability. From this perspective, today's valuations embed not only structural accounting effects but also optimistic assumptions about the long-term success of growth businesses. Ultimately earnings are an estimate, so it would be an interesting exercise to calculate an owner earnings PE figure for the S&P 500.

We had several drivers for returns in the quarter, and although our returns were not that dissimilar to the overall market, the factors for these returns were very different. We gained through the junior mining stocks, from a combination of improved results, increases in the gold price, and some re-rating. During the period we refocused on new idea generation to create a richer set of ideas to

[2] This is the Price Earnings ratio of the index as calculated by Refinitiv.

consider, and in particular we arrived at several infrastructure and AI-adjacent names. For example, TSS, Inc. had a very attractive valuation earlier in the quarter.

In late April we wrote a post about TSS, Inc. when it was trading at $7.53, giving it a market value of $189 million. Revenues had grown 172% from 2023 to 2024, driven by a 264% year-on-year increase in the systems integration segment through Q4 2024. Assuming more moderate growth and similar margins, the stock was trading at 12–13x forward earnings, or in the high single digits under more aggressive assumptions. The name re-rated within weeks, helped by shifting sentiment during the tariff relief rally, and further accelerated on May 15 when Q1 results showed revenues of $99 million, up 523% from the prior-year quarter.

The stock re-rated to above $30 by late June, pushing the valuation above $750 million. This was a difficult situation to assess with a rapidly growing company. On the one hand, growth had been exceptional; on the other, such momentum rarely lasts indefinitely, and we believed it was only a matter of time before it slowed. At that point, the earnings-based valuation appeared far less attractive. We therefore sold the position but continued to monitor the name along with several other AI infrastructure stocks, particularly those with multiple business segments that can support sales growth over a long horizon.

As of the time of writing, TSS, Inc. has fallen to the $17 area, partly due to results that disappointed the market and partly due to a public offering of common stock priced at $17 per share. Q2 revenues of $44.0 million were lower than Q1, but still represented a 262% year-on-year increase. Revenues remain lumpy at this stage in the company's life cycle, but the overall growth has been extraordinary. We will continue to look past short-term noise around these kinds of stocks and continually compare the price presented by the market to our assessment of the fundamental value of the business.

Offshore

We have built up several positions and are investigating more in what might be called the "offshore trade". This is a diverse set of businesses and sub-sectors tied to activity on the seas and oceans covering 71% of the earth's surface. Valuations appear very low across many of these names in differing business areas, in spite of robust medium-term demand drivers that are producing high growth. These include the expansion of military and defense capabilities at sea, the growing need for marine energy production and related infrastructure, and the continued build-out of telecoms and data connectivity. This is a fertile ground for mispriced securities, although the theme has presented itself to us in reverse as we found an increasing number of cheap, growing names in the same area through a variety of searches. We will explore this theme, the specific companies we believe are best positioned to perform, and some specific ideas in more detail in future letters.

Elsewhere in the portfolio, Logic Instrument continued to deliver strong operating results, supported by the benefits of recent M&A activity. In cases like this, it is often important to trust management's guidance, provided they have a record of honesty and accuracy. Here, we have a company that is projecting revenue growth from just under €30 million last year to nearly €50 million this year. While the company slightly missed guidance last year[3], even a shortfall this year, say to €44 million, would still represent a 57% increase in revenues. As we have written previously, Logic Instrument benefits from a collection of partial moats which together provide meaningful protection for the business and are driving growth.

The company is a subsidiary of Archos, run by Loïc Poirier, and there are increasing signs that the child is outgrowing the parent. In 2018, revenues at Archos were €63.4 million compared to €11.2 million at Logic Instrument; by 2024, Archos had declined to €31.4 million while Logic Instrument

[3] This was due to some last minute delays in fulfilling orders thereby moving back some revenue recognition.

had grown to €27.4 million. If Logic achieves anything close to its sales target this year, it is likely to surpass the parent in terms of the size of its income statement.

Concerns around the parent's history of dilution and lack of profitability are likely having a depressing knock-on effect on Logic Instrument's valuation. Archos has little or no moat, competing in the highly saturated consumer mobile and tablet market dominated by Samsung, Apple, and others. By contrast, Logic Instrument operates in the much more niche rugged device offshoot of the device market, where its competitors include Getac, Durabook, MilDef, and Panasonic's Toughbook line. Its moat stems from geography (a European base serving local defense and industrial markets), history (an experienced salesforce with long-standing relationships), and technical expertise (meeting demanding military and industrial specifications).

Not All Moats are Built Equally

Much has been written about moats; which companies have them, which don't, the elements of their construction, and whether those moats are growing or shrinking. To us, the black-and-white distinctions that are sometimes drawn don't capture the full picture. Every sustainable company has a moat of some kind: a durable reason why it continues to exist. Moats take different forms: some are vast, global, and compounding; others are small, local, and fragile. And there are also companies whose moats are shrinking rapidly, once-protected businesses where the advantage has eroded to the point of being vanishingly small[4].

Moat 1

An example of a small moat would be a local business that is successful within its local niche. Picture your local neighborhood, nearest village, town, area of suburbia, or city center. Is there a restaurant, shop, or service business that you know which is always full, has great service, fantastic food, friendly staff, and keeps you coming back over and over again? Others likely feel the same, and you may find yourself thinking, *"I wish I owned this place!"*

The place I am thinking of has a multi-decade history, is locally famous, and I can't imagine it ever closing unless the owner themselves went bankrupt. Even in that case, I am certain the exact same business would transfer to a new owner and remain just as successful, in fact it would be hard to disrupt it enough to make it fail.

However, I doubt it would work in most towns, and it has never opened another branch. In business terms, it probably only grows a little over inflation, but the profits are likely very healthy. This kind of business has a moat, but a very specific, localized, and limited one. To attempt to compete with it and open a similar business next door, would be very foolish, and the recipe for success would not work elsewhere. But an owner could operate it for decades and live very well off the proceeds. Does it have a moat?

- Brand → Ambience and design: the specific vibe and interior of the location.
- Operational/Business → The restaurant works well across brunch, lunch, dinner and late evening, keeping it busy throughout the day and maximizing revenue relative to fixed costs (building, staff).
- Brand/Product → Social energy and private hire: well known locally, it draws parties and has a cachet that would take years to replicate.
- Product → Good food: the core business requirement is met.

[4] Think of Eastman Kodak, whose moat shrank rapidly with the advent of digital print and photography technologies. Although it still had a strong brand moat and is even today attempting to reinvent itself. Has the branding section of its moat ultimately guaranteed its survival?

Moat 2

Now think of another business that operates as a local chain. Again, it could be a restaurant, retail, or service company. I'm thinking of one local to us. It has grown like a weed, does something special, started off in the local area and region, but now looks set to expand nationally. If you like cupcakes, Magnolia Bakery may come to mind, a business that started locally but is now recognized nationally. Its moat?

- Brand → New York-style cupcakes, featured on *Sex and the City*.
- Product → Simple to replicate at scale, with long shelf life, and seasonal editions.
- Operational → Flagship stores and control across locations.

Moat 3

Finally, let's think of a very famous, global business; highly successful, with a moat that seems obvious. But even here there are obstacles it cannot cross. As an example, let's choose Apple, Inc. It is hard to argue with the company's success, cash flow generation, growth, and uniqueness. In business terms, Apple is extraordinary, having grown through several phases to become one of the largest companies in the world, particularly in the second Steve Jobs era, from 1997 onwards until his passing.

The moat during this period?

- Brand → One of the most valuable brands ever created. Design with emotional resonance, ecosystem and user experience ("it just works"), iconic marketing and storytelling.
- Product → Seamless hardware-software integration, Apple ecosystem lock-in, and simplicity in form and function.
- Operational/Business → Vertical integration and end-to-end-control, supply chain mastery and exclusivity, Apple Stores and the Genius Bar.

So how much moat does each of these companies really have? The restaurant has a fairly strong product and branding, but may only work in the local area, not being that well known outside of a small radius. It also suffers from the issue of only being able to provide service physically to customers locally, it's unlikely to receive orders nationwide!

The second moat is stronger, with national recognition and some unusual product and brand features. But we can easily imagine competitors entering the space, food fashions changing, or the company making a misstep.

The final moat is the widest and, from 1997 onwards, was expanding rapidly. By 2010 Apple had built a massive national moat and had extended it globally. Yet even in this case it faced growing competition in Southeast Asia, although those competitors had to copy much of Apple's technology, design ideas, and product advances to compete.

Returning to Logic Instrument, it may at first appear to have little or no moat. Its main moat lies in its the niche products, but even there it has competitors. However, if globalization reduces, and products — especially those linked to military application — become more regional, that could increase its moat. The company has also won several contracts that demonstrate, as the company itself has noted, that its salesforce is deeply embedded in certain markets and customer relationships. Also the company's ISO certifications and exacting specifications of its rugged devices also create barriers to entry, since developing technologies that meet such requirements takes significant time and expertise. Taken together, these factors amount to a much larger moat than may be seen at first glance.

A comparison from the real world would be the moat of Bourtange in the Netherlands. Pictures of this fortress show a series of waterways and boggy ground partially preventing access. Although entry was technically possible for an attacking army, the fortress remained uncaptured for centuries after construction. Its complex series of partial moats made it essentially impossible to attack. Like Bourtange, which was never captured after its completion in 1593, Logic Instrument's defense does not rest on a single towering wall but on a series of layered moats that together make its position far more resilient than it first appears.

Gold Call Options

Gold has now risen into the $3,400/oz area (as of the time of writing). Although the prices of junior gold miners have risen overall, they still appear to be lagging the implied valuation of their businesses. There is a wide margin of safety between the prices of these stocks, if one thinks of them as a series of quarterly call options struck at the AISC[5] for each business, and with the gold selling price as the price of the underlying. Gold December futures now stand at $3,404/oz and, at these levels, the businesses we own are still trading on an earnings multiple of 3-4x; cheap, especially given the expected growth in production.

Last summer, when we began to notice the junior gold miners, the price of gold was around $2,500/oz. An example miner had an AISC around $1,900/oz, and set to decrease costs to $1,800/oz. That implied a selling margin of $600/oz, and the company was producing 10,000oz per quarter. This equated to an operating profit of $6 million per quarter, or $24 million per year. At the time it was value at $75 million and looked set to have cash of $20 million by the end of the year. Cheap on the face of it, or conversely, showing a large margin of safety against a fall in the gold price.

This same business is now producing 11,000oz per quarter, likely rising to 12,000oz before year-end. At a gold selling price of $3,200/oz, with no AISC improvement, the margin would be $1,300/oz, implying annual operating profit of $62.4 million. It's now valued at $244 million and has net cash of $25 million, likely increasing well above $30 million by year-end. On an enterprise valuation of $214 million, it still trades at 3.4x; a great business even after the share price has risen has risen 220%. To answer the question the reader may be asking at this point: Serabi Gold plc.

But it's not the only one. There are many other similar stocks in the gold and broader precious metals space, with a common theme of underpricing relative to current gold levels and sustaining costs, alongside growth opportunities from exploration.

Always Be Searching

We are continuing with our regular Substack posts, where we will take deeper dives into new names we are researching and markets that we think are interesting. The harder we look, the more opportunities we find. We will keep searching as hard as we can, across some of the cheapest and fastest-growing markets, sectors, and companies in the world.

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[5] All-in sustaining cost, which is meant to capture all costs in mining gold, as well as running the company, a proxy for the costs of the business.

Yours,

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